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# TRANSCRIPT OF RECORD

## SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SOUTHWEST CONSOLIDATED CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 19, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

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# TRANSCRIPT OF RECORD

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## UNITED STATES CIRCUIT COURT OF APPEALS

## FIFTH CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

SOUTHWEST CONSOLIDATED CORPORATION,

Respondent.

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On Petition to Review the Decision of the United States Board of Tax Appeals

1 DOCKET NO. 93321

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,

Amended Title:

SOUTHWEST CONSOLIDATED CORPORATION
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES:

For Petitioner: Yandell Boatner, Esq.,
A. Chauncey Newlin, Esq.,
Fred Simon, Esq.,

For Respondent: Joe D. Hughes, Esq.,

DOCKET ENTRIES:

1938

May 5—Petition received and filed. Taxpayer notified. (Fee paid)

May 6—Copy of petition served on General Counsel.

June 23—Answer filed by General Counsel.

June 23—Request for Circuit hearing in Shreveport, La. filed by General Counsel.

June 29—Notice issued placing proceeding on Shreveport, La. Calendar. Copy of answer and request served.

Sept. 1[illegible]—Motion to consolidate with 94809 and 94810 filed by taxpayer. 9/21/38 granted.

Nov. 30—Hearing set Jan. 23, 1939, Shreveport, La.

Dec. 19—Notice of appearance of A. Chauncey Newlin filed.

1939

Jan. 23—Hearing had before Mr. Smith on merits. Submitted on stipulation of facts. Stipulation filed. Appearance of Fred Simon filed. Petitioner's brief due 3/25/39. Respondent's brief due 4/25/39. Reply due 5/10/39.

Feb. 7—Transcript of hearing of Jan. 23, 1939 filed.

Mar. 13—Motion to change caption filed by taxpayer.

Mar. 15—Order changing caption to read: Southwest Consolidated Corporation, entered.

Mar. 24—Brief filed by taxpayer. 3/24/39 copy served.

June 30—Motion for leave to file brief filed by General Counsel—brief lodged. 7/1/39 granted.

July 15—Reply brief filed by taxpayer. 7/15/39 copy served.

Aug. 25—Memorandum opinion rendered — Charles P. Smith, Division 5. Decision of no deficiency will be entered.

Aug. 25—Decision entered—Charles P. Smith, Division 5.

Nov. 25—Petition for review by U. S. Circuit Court of Appeals, Fifth Circuit, with assignments of error filed by General Counsel.

2 1939
Dec. 4—Proof of Service filed by General Counsel (2).

1940
Jan. 20—Copy of order from U. S. Circuit Court of Appeals, Fifth Circuit, extending the time to March 25, 1940 for preparation of the evidence and transmission of the record, filed.

Mar. 20—Certified copy of order from Fifth Circuit extending the time to April 25, 1940 for preparation of the evidence and transmission of the record, filed.

Apr. 24—Praecipe for record filed by General Counsel—proof of service and agreement thereon.

Apr. 25—Order enlarging time for transmission of record to May 15, 1940, entered.

3 Filed May, 5, 1938

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION
*Petitioner*

vs.

COMMISSIONER OF INTERNAL REVENUE
*Respondent*

Docket No. 93321

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated

February 17, 1938 (Symbols IT:C:8-WLM:90D), and as a basis for its proceedings alleges as follows:

1. The petitioner is a corporation with its principal office at Rooms 901 to 913 Slattery Building, Shreveport, Louisiana.

2. The notice of deficiency (a copy of which is attached and marked EXHIBIT I) was mailed to the petitioner on February 17, 1938.

3. The taxes in controversy are income and excess profits taxes for the taxable years ended December 31, 1934 and 1935; and are for the amount of $47,682.41.

4. The determination of the taxes set forth in the said notice of deficiency are based upon the following errors:

4

I

The respondent erred in ruling that the petitioner was not a reorganization but a new corporation, within the purview of section 112 (g) (1) of the Revenue Act of 1934.

II

The respondent erred in finding that the cost of the petitioner of assets acquired from Southwest Gas Utilities Corporation on June 27, 1934 was the sum of $752,000.00; and in not finding that the said cost was the sum of $1,766,694.98.

III

The respondent erred in finding that the basis to the petitioner for determining gain or loss on said assets of Southwest Gas Utilities Corporation was cost to the petitioner; and in not finding that the basis to the petitioner was the substituted basis provided for in section 113 (a)

(7) of the Revenue Act of 1934 of cost to Southwest Gas Utilities Corporation of $8,995,724.91.

IV

The respondent erred in reducing bad debt loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1934 from the sum of $75,090.00 to the sum of $1.26.

V

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1934 the sum of $60,700.69 as alleged gain realized from interest collected.



VI

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1934 the sum of $19,530.10 as alleged gain realized from the collection of advances.

VII

The respondent erred in reducing worthless stock loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1935, from the sum of $3,477,577.00 to the sum of $1.48.

VIII

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1935 the sum of $25,174.80 as alleged gain realized from collections from affiliates.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

I

## ERROR WITH RESPECT TO REORGANIZATION

(a) The Southwest Gas Utilities Corporation, a corporation organized under the laws of the State of Delaware, was placed in receivership in the Court of Chancery for the State of Delaware in and for Newcastle County on December 31, 1933.

(b) The Chancellor of said Court of Chancery signed a decree on May 11, 1934 approving a plan of Reorganization of Southwest Gas Utilities Corporation, said plan having been submitted to the Court on March 16, 1934 by a Reorganization Committee representing
6 all security holders, creditors and stockholders of Southwest Gas Utilities Corporation.

(c) The Plan of Reorganization of Southwest Gas Utilities Corporation, as approved by the Chancellor of said Court, provided for the organization of a new company to acquire the assets of Southwest Gas Utilities Corporation in exchange for shares of common voting stock of the new company and option warrants to purchase additional shares of common voting stock of the new company.

(d) The Chancellor of said Court of Chancery in the said decree of May 11, 1934, assumed jurisdiction for the supervision and carrying out of the Plan of Reorganization, and for the supervision of the issuance of securities proposed to be issued thereunder.

(e) In accordance with the provisions of the Plan of Reorganization, the receivers of Southwest Gas Utilities Corporation held a sale of the properties and assets of Southwest Gas Utilities Corporation, including the equity of redemption in and to all of the securities and cash pledged with and held by the Manufacturers Trust Company, as Trustee under Trust Indenture dated May 1, 1928, securing First Lien and Secured Sinking Fund Gold Bonds,

6½% Series, of Southwest Gas Utilities Corporation; at which sale the Reorganization Committee was the highest bidder. Decree confirming the sale was signed by the Chancellor of the said Court of Chancery on June 20, 1934.

(f) In further pursuance of the Plan of Reorganization, and in accordance with provisions therein, the Manufacturers Trust Company, as Trustee, held a sale of the securities and cash pledged with and held by it under the Trust Indenture dated May 1, 1928; at which sale the Reorganization Committee was likewise the highest bidder. Decree confirming the sale was signed by the Chancellor of the said Court of Chancery on June 27, 1934.

(g) The petitioner was organized on June 27, 1934 by the Reorganization Committee under the laws of the State of Delaware, as the new company provided for in the Plan of Reorganization.

(h) The Reorganization Committee assigned to the petitioner the accepted bids made by it as receivers' and trustee's sales, in consideration of the petitioner assuming all of the liabilities and obligations of the Reorganization Committee under the terms of the bids and the decrees confirming the sales.

(i) The petitioner duly discharged the liabilities and obligations of the Reorganization Committee and consummated the reorganization of Southwest Gas Utilities Corporation by,

(A) issuing 49,010 shares of petitioner's common voting stock for distribution to holders of $2,450,500.00 principal amount of First Lien and Secured Sinking Fund Gold Bonds, 6½% Series, of Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization, and by

(B) depositing with the Manufacturers Trust Company as Trustee, the sum of $95,676.46 for distribution

to holders of $421,000,000 principal amount of said bonds, who had not assented to the Plan of Reorganization, and by

8 (C) issuing 276 shares of petitioner's common voting stock and option warrants to purchase 2760 additional shares of petitioner's common voting stock, for distribution to holders of $138,000.00 principal amount of unsecured claims against Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization, and by

(D) depositing with the receivers of the Southwest Gas Utilities Corporation the sum of $11,007.60 for distribution to holders of $9,000.00 principal amount of unsecured claims against Southwest Gas Utilities Corporation who had not assented to the Plan of Reorganization, and to the holders of $421,000.00 principal amount of said bonds who had not assented to the Plan, and by

(E) issuing option warrants to purchase 17,297 shares of petitioner's common stock to holders of 17,297 shares of preferred stock of Southwest Gas Utilities Corporation, who has assented to the Plan of Reorganization, and by

(F) issuing option warrants to purchase 1,148 7/50 shares of petitioner's common voting stock to holders of 57,470 shares of common stock of Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization.

(j) The entire assets and properties of Southwest Gas Utilities Corporation as at June 27, 1934 were transferred to petitioner by instruments signed by Southwest Gas Utilities Corporation through its proper office, and by the receivers of Southwest Gas Utilities Corporation, and in the case of pledged assets by Manufacturers Trust Company as Trustee.

9

II

ERROR WITH RESPECT TO COST OF ASSETS OF SOUTHWEST GAS UTILITIES CORPORATION

(a) The petitioner did not purchase the assets of Southwest Gas Utilities Corporation on June 27, 1934 for a cash consideration of $752,000.00, but acquired these assets in exchange for the petitioner's common voting stock and option warrants to purchase common voting stock of petitioner.

(b) Cost to Southwest Gas Utilities Corporation of assets transferred to petitioner as at June 27, 1934 was the sum of $8,995,724.91.

(c) The fair market value of said assets on June 27, 1934, date of acquisition by petitioner, was the sum of $1,766,694.98.

III

ERROR WITH RESPECT TO PETITIONER'S BASIS FOR DETERMINATION OF GAIN OR LOSS

(a) Immediately after the transfer of the assets of Southwest Gas Utilities Corporation to the petitioner, former security holders and stockholders of Southwest Gas Utilities Corporation owned more than 80 percentum of the common voting stock of petitioner, and more than 80 percentum of option warrants for the purchase of common voting stock of the petitioner.

(b) Immediately after the transfer of said assets to petitioner, it had outstanding no securities or stock other than common voting stock and option warrants to purchase common voting stock.

10

IV

ERROR WITH RESPECT TO BAD DEBT LOSS

(a) Principal amount of debts due to the petitioner and charged off during the taxable year ended December 31, 1934, and claimed by the petitioner as a bad debt loss in its income tax return for the same period was the sum of $75,090.00.

(b) Cost of the said debts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to the petitioner was the sum of $75,090.00.

V

ERROR WITH RESPECT TO GAIN REALIZED FROM INTEREST COLLECTED

(a) Total amount of interest collected by petitioner during the taxable year ended December 31, 1934 from interest receivable accounts acquired from Southwest Gas Utilities Corporation on June 27, 1934, was the sum of $104,896.46.

(b) Cost of the said interest receivable accounts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to the petitioner was the sum of $104,896.46.

VI

ERROR WITH RESPECT TO GAIN REALIZED FROM COLLECTION OF ADVANCES

(a) Total amunt of advances collected by petitioner during the taxable year ended December 31, 1934 from accounts of subsidiaries acquired from Southwest Gas Utilities Corporation as at June 27, 1934, was the sum of $33,749.75.

11 (b) Cost of said subsidiaries accounts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $33,749.75.

VII

ERROR WITH RESPECT TO WORTHLESS STOCK LOSS

(a) Loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1935, for worthless stocks acquired from Southwest Gas Utilities Corporation as at June 27, 1934, was the sum of $3,477,577.00.

(b) Cost of said stock to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $3,477,577.00.

VIII

ERROR WITH RESPECT TO GAIN REALIZED FROM COLLECTIONS FROM AFFILIATES

(a) Total amount collected by petitioner during the taxable year ended December 31, 1935, from accounts of affiliates acquired from Southwest Gas Utilities Corporation as at June 27, 1934 was the sum of $43,540.28.

(b) Cost of said accounts of affiliates to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $43,540.28.

WHEREFORE the petitioner prays that this Board may hear the proceedings and determine:

(A) That the petitioner acquired the assets and properties of Southwest Gas Utilities Corporation on
12 June 27, 1934 in a "reorganization" within the purview of Section 112 (g) (1) of the Revenue Act of 1934, and

(B) that the basis for determination of gain or loss to the petitioner on said assets and properties of Southwest Gas Utilities Corporation is the same as it would be in the hands of Southwest Gas Utilities Corporation, as provided for in Section 113 (a) (7) of the Revenue act of 1934, and

(C) that the said basis to Southwest Gas Utilities Corporation was cost to Southwest Gas Utilities Corporation in the sum of $8,995,724.91, and

(D) that there is no deficiency due from the petitioner for the taxable year ended December 31, 1934, nor for the taxable year ended December 31, 1935, or in the alternative,

(E) if this Board determines that the basis for determination of gain or loss to the petitioner on assets of Southwest Gas Utilities Corporation acquired on June 27, 1934, is not the said substituted basis, but is cost to petitioner; that the cost to the petitioner was the sum of $1,766,694.98; and that the deficiency, if any, due by the petitioner for the taxable year ended December 31, 1934, and for the taxable year ended December 31, 1935, be computed upon and from the application of said cost of $1,766,694.98.

YANDELL BOATNER,
Counsel for Petitioner
Yandell Boatner
Ricou Brewster Building
Shreveport, Louisiana.

13 State of Louisiana )
Parish of Caddo )

George Belchic, being duly sworn, says that he is the Vice President of Southwest Consolidated Gas Utilities Corporation, the petitioner above named; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements

contained therein, and that the facts stated are true, except those stated to be upon information and belief, and that these he believes to be true.

GEORGE BELCHIC

Subscribed to and sworn before me this the 30th day of April, 1938.

FRED SIMON,
Notary Public

(SEAL)

14 "EXHIBIT I"

TREASUY DEPARTMENT

WASHINGTON

Office of
COMMISSIONER OF INTERNAL REVENUE

February 17, 1938

Southwest Consolidated Gas Utilities Corporation,
901-913 Slattery Building,
Shreveport, Louisiana.

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1934 and 1935 discloses a deficiency of $39,614.75 and that the determination of your excess-profits tax liability for the year(s) mentioned discloses a deficiency of $8,067.66 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiencies mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may

file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies above stated.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
Guy T. Helvering,
Commissioner.
By: Chas. T. Russell
Deputy Commissioner.

Enclosures:
Statement
Form 870
Exhibit A

16 STATEMENT

IT:C:8
WLM:90D

Southwest Consolidated Gas Utilities Corporation,
901-913 Slattery Building,
Shreveport, Louisiana.

Tax Liability for Taxable Years Ended December 31, 1934 and 1935.

Income Tax Liability

| Year | Liability | Assessed | Deficiency |
|---|---|---|---|
| 1934 | $14,991.68 | None | $14,991.68 |
| 1935 | 24,623.07 | None | 24,623.07 |
| Totals | $39,614.75 | | $39,614.75 |

Excess-Profits Tax Liability

| | | | |
|---|---|---|---|
| 1934 | $3,545.27 | None | $3,545.27 |
| 1935 | 4,522.39 | None | 4,522.39 |
| Totals | $8,067.66 | | $8,067.66 |

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the internal revenue agent's reports dated August 22, 1936, and February 23, 1937; to your protests dated October 28, 1936, June 30, 1937, and supplemental data submitted; and to the statements made at the conferences held in New Orleans, Louisiana on January 25, 1937 and the one held in Washington, D. C., on July 2, 1937.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop
17 the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form 870, inserting therein the amount of the deficiency you desire to have as-

sessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

Taxable Year Ended December 31, 1934

Adjustments to Net Income

| | |
|---|---|
| Net loss as disclosed by return, period June 27, 1934 to December 31, 1934 | ($ 48,307.10) |
| As corrected (net income) | 109,030.43 |
| Total adjustment as computed below | $157,337.53 |

Unallowable deductions and additional income:

| | | |
|---|---|---|
| (a) Capital net gain restored | $ 20.00 | |
| (b) Capital net loss disallowed | 2,000.00 | |
| (c) Bad debts disallowed | 75,086.74 | |
| (d) Gain realized from interest collected | 60,700.69 | |
| (e) Gain realized from collection of advances | 19,530.10 | |
| Total | | $157,337.53 |

18 Explanation of Adjustments

(a) Capital net gain restored $20.00.

The capital net gain is computed as follows:

Southwest Gas Companies bonds:

| | |
|---|---|
| Selling price | $897.50 |
| Cost | 877.50 |
| Gain | $ 20.00 |

This adjustment is made to the income shown on the return because it was included in the capital gain or loss scheduled on the return, which showed a loss of $981,916.18. This loss was limited to $2,000.00 on the return.

(b) Capital net loss disallowed $2,000.00:

This item is restored to the net income inasmuch as this office has ruled that your corporation was not a reorganization but a new corporation, within the purview of section 112(g)(1) of the Revenue Act of 1934.

(c) Bad debts disallowed $75,086.74:

Certain accounts purchased at the foreclosure sale of the assets of Southwest Gas Utilities Corporation were found to be worthless and charged off in 1934 through appraisal, as follows:

| | |
|---|---|
| Edmond Seymour and Company | $ 6,885.00 |
| Southwest Gas Company (Delaware) | 53,505.00 |
| Peoples Gas and Fuel Company | 14,700.00 |
| Total | $75,090.00 |

19 The cost thereof as shown in exhibit A:

| | | |
|---|---|---|
| Edmond Seymour and Company | $ .42 | |
| Southwest Gas Company (Delaware) | .42 | |
| Peoples Gas and Field Company | .42 | 1.26 |
| Bad debts allowed | | $75,088.74 |

Only the cost of the assets can be allowed as a deduction.

(d) Gain realized from interest collected $60,700.69:

Of the assets purchased by you at the foreclosure sale of the Southwest Gas Utilities Corporation there were the following interest receivable accounts which were collected subsequent to purchase but prior to December 31, 1934:

| | | |
|---|---|---|
| Southwest Gas Company (Delaware) | | $ .54.16 |
| Northwest Louisiana Gas Company | | 590.42 |
| Peoples Gas and Fuel Company | | 739.38 |
| Southwest Gas Utilities Corporation of Oklahoma | | 103,512.50 |
| Total collections | | $104,896.46 |

The cost of said accounts as shown in exhibit A:

| | | |
|---|---|---|
| Southwest Gas Company (Delaware) | $ 22.82 | |
| Peoples Gas and Fuel Company | 311.69 | |
| Northwest Louisiana Gas Company | 248.76 | |
| Southwest Gas Utilities Corporation of Oklahoma | 43,612.50 | 44,195.77 |
| Gain realized | | $ 60,700.69 |

20 (e) Gain realized from collection of advances $19,530.10:

Certain advances made by the Southwest Gas Utilities Corporation to its subsidiaries were purchased by you at foreclosure sale. The following amounts were collected by you subsequent to such foreclosure but prior to December 31, 1934.

| | |
|---|---|
| Southwest Gas Company (Delaware) | $ 1,431.61 |
| Southwest Gas Utilities Corporation of Oklahoma | 765.12 |
| Northwest Louisiana Gas Company (Accrued Interest) | 31,553.02 |
| Total collections | $ 33,749.75 |

The cost of said accounts as shown in exhibit A:

| | | |
|---|---|---|
| Southwest Gas Company (Delaware) | $ 603.18 | |
| Southwest Gas Utilities Corporation of Oklahoma | 322.37 | |
| Northwest Louisiana Gas Company | 13,294.10 | 14,219.65 |
| Net gain realized | | $ 19,530.10 |

Computation of Tax

Income Tax

| | |
|---|---|
| Net income for taxable year | $109,030.43 |
| Income tax at 13¾ % | $ 14,991.68 |
| Total previously assessed No. 854725 | None |
| Additional income tax to be assessed | $ 14,991.68 |

| | |
|---|---|
| 21 Capital stock value declared on capital stock returns for excess-profits tax purposes | $609,000.00 |
| Exemption claimed for excess-profits tax purposes | $ 75,000.00 |

Excess-Profits Tax

| | |
|---|---|
| Net income | $109,030.43 |
| Excess-profits credit 6/120 of $75,000.00 | 38,125.00 |
| Net income subject to excess-profits tax at 5% | $ 70,905.43 |
| Excess-profits tax | $ 3,545.27 |
| Previously assessed No. 854725 | None |
| Additional excess-profits tax to be assessed | $ 3,545.27 |

Taxable Year Ended December 31, 1935

Adjustments to Net Income

| | | |
|---|---|---|
| Net loss as disclosed by return | | ($3,392,737.55) |
| As corrected (net income) | | 179,076.90 |
| Net adjustment as computed below | | $3,571,814.45 |
| Unallowable deductions and additional income: | | |
| (a) Worthless stocks disallowed | $3,477,577.00 | |
| (b) Capital net gain restored | 67,064.13 | |
| (c) Capital net loss disallowed | 2,000.00 | |
| (d) Gain from collections from affiliates | 25,174.80 | |
| Total | | $3,571,815.93 |
| Additional deduction: | | |
| (e) Loss on worthless stocks | | 1.48 |
| Net adjustment as above | | $3,571,815.45 |

22 Explanation of Adjustments

(a) Worthless stocks disallowed $3,477,577.00:

The Southwest Gas Company of Oklahoma and the Southwest Gas Company of Delaware were carried through bankruptcy under section 77-B of the National Bankruptcy Act in 1935.

The losses on stock claimed in the return based on the book value of the preferred and common stocks of the above-named corporation have been disallowed as a deduc-

tion, and in lieu of the loss deducted on the return the cost of the stocks has been allowed as a deduction.

The losses claimed consist of the following:

| Name of Company | Preferred Stock | Common Stock | Total |
|---|---|---|---|
| Southwest Gas Company (Delaware) | $284,378.00 | $2,093,199.00 | $2,377,577.00 |
| Southwest Gas Company of (Oklahoma) | 500,000.00 | 600,000.00 | 1,100,000.00 |
| Total | $784,378.00 | $2,693,199.00 | $3,477,577.00 |

The cost of said stocks as shown in exhibit A is as follows:

| Name of Company | Preferred Stock | Common Stock | Total |
|---|---|---|---|
| Southwest Gas Company (Delaware) | $ .42 | $ .22 | $ .64 |
| Southwest Gas Company of (Oklahoma) | .42 | .42 | .84 |
| Total | $ .84 | $ .64 | $ 1.48 |

23 (b) Capital net gain restored $67,064.13:

This item is restored to the net income inasmuch as this office has ruled that your corporation was not a reorganization, but a new corporation within the purview of section 112(g)(1) of the Revenue Act of 1934. Therefore since the total loss in schedule B has been disallowed the gain as shown below should be restored to income:

| | Cost | Selling Price | Gain |
|---|---|---|---|
| First Mortgage Bonds | $127,199.75 | $193,063.88 | $65,864.13 |
| Preferred stock | 390.00 | 1,590.00 | 1,200.00 |
| Total | | | $67,064.13 |

(c) Capital net loss disallowed $2,000.00:

This item, which was taken as a deduction on the return, is restored to the net income as no loss was sustained on the sale of the assets received from the Southwest Gas Utilities Corporation, as this office has ruled that there was no reorganization of that company within the purview of Section 112(g)(1) of the Revenue Act of 1934.

(d) Gain from collections from affiliates $25,174.80:

The amounts collected in 1935 on the accounts purchased at the foreclosure sale of the assets of the Southwest Gas Utilities Corporation are as follows:

| | |
|---|---|
| Peoples Gas and Fuel Company Part | $ 7,200.00 |
| Northwest Louisiana Gas Company Part | 36,304.28 |
| Total collected | $43,504.28 |
| The cost of the accounts so collected is 42.132% of collections or | 18,329.48 |
| Net gain realized | $25,174.80 |

24 The difference between the allocated cost of the accounts and the amount collected thereon during the year is added to the income in accordance with the ruling of this office that the assets of the Southwest Gas Utilities Corporation was acquired by purchase and not as the result of a nontaxable reorganization.

(e) Loss on worthless stock $1.48:

This represents the cost of the stock which is allowed as a deduction in 1935, because it becomes worthless and was

written off as a loss. The allocated cost of the stock is shown in item (a).

Computation of Tax

Income Tax

| | |
|---|---|
| Net income for taxable year | $179,067.90 |
| Income tax at 13¾% | $ 24,623.07 |
| Total previously assessed No. 851187 | None |
| Additional income tax to be assessed | $ 24,623.07 |
| Capital stock value declared on capital stock tax returns for excess-profits tax purposes | $709,033.43 |
| Exemption claimed for excess-profits tax purposes | $ 88,629.18 |

Excess-Profits Tax

| | |
|---|---|
| Net income | $179,076.90 |
| Excess-profits tax exemption | 88,629.18 |
| Net income subject to excess-profits tax | $ 90,447.72 |
| Excess-profits tax at 5% | $ 4,522.39 |
| Previous assessment No. 851187 | None |
| Additional excess-profits tax to be assessed | $ 4,522.39 |

25 A copy of this letter and statement has been mailed to your representative Mr. A, L. Tillotson, Slattery Building, Shreveport, Louisiana, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Southwest Consolidated Gas Utilities Corporation.

Open Balance Sheet and Adjustments

| | Books S.W. G. U. Corp. June 27, 1934 | Adjustments Debit | Adjustments Credit | Books SW. C. G. U. Corp. June 27, 1934 |
|---|---|---|---|---|
| Cash: | | | | |
| Cash Richards and Laskey Revrs. | $ 3,281.34 | $ | $ | $ 3,281.34 |
| Cash Manufacturers Trust Co. Trustee | 5,849.19 | | | 5,849.18 |
| Cash Matured Coupons | 4,078.75 | | | 4,078.75 |
| Total Cash | $ 13,209.27 | | | $ 13,209.27 |
| Edmond Seymour and Co. | $ 6,885.00 | | | $ 6,885.00 |
| Receivables: | | | | |
| Open Accounts: | | | | |
| Southwest Gas Utilities Service Co. | $ 90,891.39 | | | $ 90,891.39 |
| Southwest Gas Co. (Delaware) | 1,431.61 | | | 1,431.61 |
| Southwest Gas Co. (Oklahoma) | 765.12 | | | 765.12 |
| Peoples Gas and Fuel Company | 16,778.22 | | | 16,778.22 |
| Total open accounts | $ 109,866.34 | | | $ 109,866.34 |
| Interest Receivable: | | | | |
| 1st Mortgage Bonds: | | | | |
| Southwest Gas Co. (Delaware) | $ 54.16 | | | $ 54.16 |
| Northwest Louisiana Gas | 590.42 | | | 590.42 |
| Peoples Gas and Fuel Co. | 739.38 | | | 739.38 |
| Southwest Gas Utilities Corp. of Oklahoma | 103,512.50 | | | 103,512.50 |
| Southwest Gas Utilities Corp. of Texas | 26,054.17 | | | 26,054.17 |
| Gen. Mortgage Bonds: | | | | |
| Southwest Gas Co. Delaware | 53,505.00 | | | 53,505.00 |
| Peoples Gas and Fuel Co. | 14,700.00 | | | 14,700.00 |
| 1st Mortgage Notes | 13,162.50 | | | 13,162.50 |
| Total Interest Receivable: | $ 212,318.13 | | | $ 212,318.13 |
| Accrued Interest: | | | | |
| Southwest Gas Utilities Service Co. | $ 5,950.00 | | | $ 5,950.00 |
| Northwest Louisiana Gas Co. | 147,014.43 | | | 147,014.43 |
| Peoples Gas and Fuel Co. | 44,381.87 | | | 44,381.87 |
| Composs Gas Co. | 11,212.50 | | | 11,212.50 |

Open Balance Sheet and Adjustments

EXHIBIT A

| | Books S.W. G. U. Corp. June 27, 1934 | Adjustments Debit | Adjustments Credit | Books SW. C. G. U. Corp. June 27, 1934 | Adjustments Debit | Adjustments Credit | Appraised Value June 27, 1934 | Adjustments Debit | Adjustments Credit | Cost Basis June 27, 1934 |
|---|---|---|---|---|---|---|---|---|---|---|
| | $ 3,281.34 | $ | $ | $ 3,281.34 | $ | $ | $ 3,281.34 | $ | $ | $ 3,281.34 |
| | 5,849.19 | | | 5,849.18 | | | 5,849.18 | | | 5,849.18 |
| | 4,078.75 | | | 4,078.75 | | | 4,078.75 | | | 4,078.75 |
| | $ 13,209.27 | | | $ 13,209.27 | | | $ 13,209.27 | | | $ 13,209.27 |
| | $ 6,885.00 | | | $ 6,885.00 | | $ 6,884.00 | $ 1.00 | | $ .58 | $ .42 |
| | | | | | | | $ 1.00 | | | |
| | $ 90,891.39 | | | $ 90,891.39 | | | 90,891.39 | | | $ 38,295.91 |
| | 1,431.61 | | | 1,431.61 | | | 1,431.61 | | | 603.18 |
| | 765.12 | | | 765.12 | | | 765.12 | | | 322.37 |
| | 16,778.22 | | | 16,778.22 | | | 16,778.22 | | | 7,069.10 |
| | $ 109,866.34 | | | $ 109,866.34 | | | $ 109,867.34 | | $ 63,575.78 | $ 48,290.56 |
| | $ 54.16 | | | $ 54.16 | | | $ 54.16 | | | $ 22.82 |
| | 590.42 | | | 590.42 | | | 590.42 | | | 248.76 |
| | 739.38 | | | 739.38 | | | 739.38 | | | 311.69 |
| | 103,512.50 | | | 103,512.50 | | | 103,512.50 | | | 43,612.50 |
| | 26,054.17 | | | 26,054.17 | | | 26,054.17 | | | 10,977.30 |
| | 53,505.00 | | | 53,505.00 | | $ 53,504.00 | 1.00 | | | .42 |
| | 14,700.00 | | | 14,700.00 | | 14,699.00 | 1.00 | | | .42 |
| | 13,162.50 | | | 13,162.50 | | | 13,162.50 | | | 5,545.70 |
| | $ 212,318.13 | | | $ 212,318.13 | | $ 68,203.00 | $ 144,115.13 | | $ 83,395.52 | $ 60,719.61 |
| | $ 5,950.00 | | | $ 5,950.00 | | | $ 5,950.00 | | | $ 2,506.89 |
| | 147,014.43 | | | 147,014.43 | | | 147,014.43 | | | 61,941.44 |
| | 44,381.87 | | | 44,381.87 | | | 44,381.87 | | | 18,699.24 |
| | 11,212.50 | | | 11,212.50 | | $ 11,212.50 | | | | |
| | $ 208,558.80 | | | $ 208,558.80 | | $ 11,212.50 | $ 197,346.30 | | | $ 83,147.57 |
| | 537,628.27 | | | $ 537,628.27 | | $ 86,299.50 | $ 451,328.77 | | $ 261.170.61 | $ 190,158.16 |

| | | | | |
|---|---|---|---|---|
| Total open accounts | | | | |
| Interest Receivable: | | | | |
| 1st Mortgage Bonds: | | | | |
| Southwest Gas Co. (Delaware) | | $ 54.16 | | $ 54.16 |
| Northwest Louisiana Gas | | 590.42 | | 590.42 |
| Peoples Gas and Fuel Co. | | 739.38 | | 739.38 |
| Southwest Gas Utilities Corp. of Oklahoma | | 103,512.50 | | 103,512.50 |
| Southwest Gas Utilities Corp. of Texas | | 26,054.17 | | 26,054.17 |
| Gen. Mortgage Bonds: | | | | |
| Southwest Gas Co. Delaware | | 53,505.00 | | 53,505.00 |
| Peoples Gas and Fuel Co. | | 14,700.00 | | 14,700.00 |
| 1st Mortgage Notes | | 13,162.50 | | 13,162.50 |
| Total Interest Receivable: | | $ 212,318.13 | | $ 212,318.13 |
| Accrued Interest: | | | | |
| Southwest Gas Utilities Service Co. | | $ 5,950.00 | | $ 5,950.00 |
| Northwest Louisiana Gas Co. | | 147,014.43 | | 147,014.43 |
| Peoples Gas and Fuel Co. | | 44,381.87 | | 44,381.87 |
| Composs Gas Co. | | 11,212.50 | | 11,212.50 |
| Total Accrued Interest | | $ 208,558.80 | | $ 208,558.80 |
| Total Receivables | | 537,628.27 | | $ 537,628.27 |
| Investments: | | | | |
| Preferred Stock: | | | | |
| Southwest Gas Co. (Delaware) | 2,850 shares | $ 284,378.00 | | $ 284,378.00 |
| Southwest Gas Co. of Oklahoma | 5,000 shares | 500,000.00 | | 500,000.00 |
| Northwest Louisiana Gas Co. | 50 shares | 2,125.00 | | 2,125.00 |
| Southwest Utilities Service Co. | 4,151 shares | 415,100.00 | | 415,100.00 |
| Total Preferred Stock | | $1,201,603.00 | | $1,201,603.00 |
| Common Stock: | | | | |
| Southwest Gas Co. (Delaware) | 175,000 shares | $2,093,199.00 | | $2,093,199.00 |
| Southwest Gas Co. of Oklahoma | 20,000 shares | 600,000.00 | | 600,000.00 |
| Northwest Louisiana Gas Co. | 59,238 shares | 889,920.00 | | 889,920.00 |
| Composs Gas Co. | 2,000 shares | 212,271.08 | | 212,271.08 |
| Southwest Gas Utilities Service Co. | 1,000 shares | 626,541.00 | | 626,541.00 |
| Southwest Gas Utilities Corp. Oklahoma | 2,000 shares | 2,000.00 | | 2,000.00 |
| Southwest Gas Utilities Corp. of Texas | 10 shares | 77,863.54 | | 77,863.54 $ |
| Total Common Stock | | $4,501,794.62 | | $4,501,794.62 $ |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | $ 54.16 | | | $ 54.16 | | | $ 54.16 | | | $ 22.82 |
| | | 590.42 | | | 590.42 | | | 590.42 | | | 248.76 |
| | | 739.38 | | | 739.38 | | | 739.38 | | | 311.69 |
| | | 103,512.50 | | | 103,512.50 | | | 103,512.50 | | | 43,612.50 |
| | | 26,054.17 | | | 26,054.17 | | | 26,054.17 | | | 10,977.30 |
| | | 53,505.00 | | | 53,505.00 | | $ 53,504.00 | 1.00 | | | .42 |
| | | 14,700.00 | | | 14,700.00 | | 14,699.00 | 1.00 | | | .42 |
| | | 13,162.50 | | | 13,162.50 | | | 13,162.50 | | | 5,545.70 |
| | | $ 212,318.13 | | | $ 212,318.13 | | $ 68,203.00 | $ 144,115.13 | | $ 83,395.52 | $ 60,719.61 |
| | | $ 5,950.00 | | | $ 5,950.00 | | | $ 5,950.00 | | | $ 2,506.89 |
| | | 147,014.43 | | | 147,014.43 | | | 147,014.43 | | | 61,941.44 |
| | | 44,381.87 | | | 44,381.87 | | | 44,381.87 | | | 18,699.24 |
| | | 11,212.50 | | | 11,212.50 | | $ 11,212.50 | | | | |
| | | $ 208,558.80 | | | $ 208,558.80 | | $ 11,212.50 | $ 197,346.30 | | | $ 83,147.57 |
| | | 537,628.27 | | | $ 537,628.27 | | $ 86,299.50 | $ 451,328.77 | | $ 261,170.61 | $ 190,158.16 |
| 2,850 | shares | $ 284,378.00 | | | $ 284,378.00 | | $ 284,377.00 | $ 1.00 | | | $ .42 |
| 5,000 | shares | 500,000.00 | | | 500,000.00 | | 499,999.00 | 1.00 | | | .42 |
| 50 | shares | 2,125.00 | | | 2,125.00 | | 2,124.00 | 1.00 | | | .42 |
| 4,151 | shares | 415,100.00 | | | 415,100.00 | | | 415,100.00 | | | 174,892.42 |
| | | $1,201,603.00 | | | $1,201,603.00 | | $ 786,500.00 | $ 415,103.00 | | $ 240,209.32 | $ 174,893.68 |
| 175,000 | shares | $2,093,199.00 | | | $2,093,199.00 | | $2,093,198.50 | $ .50 | | | $ .22 |
| 20,000 | shares | 600,000.00 | | | 600,000.00 | | 599,999.00 | 1.00 | | | .42 |
| 59,238 | shares | 889,920.00 | | | 889,920.00 | | 889,919.50 | .50 | | | .22 |
| 2,000 | shares | 212,271.08 | | | 212,271.08 | | 212,271.08 | -0- | | | |
| 1,600 | shares | 626,541.00 | | | 626,541.00 | | 533,482.39 | 93,058.61 | | | 39,208.01 |
| 2,000 | shares | 2,000.00 | | | 2,000.00 | | | 2,000.00 | | | 842.65 |
| 10 | shares | 77,863.54 | | | 77,863.54 | $ 113,169.79 | | 191,033.33 | | | 80,487.31 |
| | | $4,501,794.62 | | | $4,501,794.62 | $ 113,169.79 | $4,328,870.47 | $ 286,093.94 | | $ 165,555.11 | $ 120,538.83 |

Open Balance Sheet and Adjustments

Southwest Consolidated Gas Utilities Corporation.

| Assets | Books SW. G. U. Corp. June 27, 1934 | Adjustments Debit | Adjustments Credit | Books SW. C. G. U. Corp June 27. 1934 |
|---|---|---|---|---|
| 1st Mortgage Bonds: | | | | |
| Southwest Gas Co. (Delaware) | $ 3,200.00 | $ | $ | $ 3,200.00 |
| Northwest Louisiana Gas Co. | 109,000.00 | | | 109,000.00 |
| Peoples Gas and Fuel Co. | 45,500.00 | | | 45,500.00 |
| Southwest Gas Utilities Corp. of Oklahoma | 735,000.00 | | | 735,000.00 |
| Southwest Gas Utilities Corp. of Texas | 185,000.00 | | | 185,000.00 |
| Total 1st Mortgage Bonds | $1,077,700.00 | | | $1,077,700.00 |
| General Mortgage Bonds: | | | | |
| Southwest Gas Co. (Delaware) | $ 344,400.00 | | | $ 344,400.00 |
| Peoples Gas and Fuel Co. | 85,450.00 | | | 85.450.00 |
| Total General Mortgage Bonds | $ 429,850.00 | | | $ 429,850.00 |
| 1st Mortgage Notes: | | | | |
| Peoples Gas and Fuel Co. | $ 90,000.00 | | | $ 90,000.00 |
| Total Investments | $7,300,947.62 | | | $7.300,947.62 |
| Unsecured Notes: | | | | |
| Southwest Gas Utilities Service Co. | $ 30,000.00 | | | $ 30,000.00 |
| Composs Gas Co. | 338,141.00 | | | 338,141.00 |
| Northwest Louisiana Gas Co. | 576,341.25 | | | 576,341.25 |
| Peoples Gas and Fuel Co. | 199,457.50 | | | 199,457.50 |
| Total Unsecured Notes | $1,143,939.75 | | | $1,143,939.75 |
| Total Assets | $8,995,724.91 | | | $8,995,724.91 |
| Liabilities: | | | | |
| Accounts Payable | $ 31,945.42 | $ 31,945.42 | $ 108.197.92 | $ 108,197.92 |
| Accrued Interest Bonds | 425,608.14 | 425,608.14 | | |
| Accrued Interest Notes | 13,740.30 | 13,740.30 | | |
| Five Year Notes Payable | 126,000.00 | 126,000.00 | | |
| Bonds Payable | 2,871,500.00 | 2,871,500.00 | | |
| Capital: | | | | |
| Preferred Stock | 2,684,376.50 | 2,684,376.50 | | |
| Common Stock | 2,801,509.00 | 2,801,509.00 | 49,168.00 | 49,168.00 |
| Surplus | 41,045.55 | 41,045.55 | | |
| Reorganization Surplus | | 157,265.02 | 8,995,724.91 | 8,838.358.99 |
| Total Liabilities | $8,995,724.91 | | | $8,995,724.91 |

Open Balance Sheet and Adjustments

EXHIBIT A

| | Books SW. G. U. Corp. June 27, 1934 | Adjustments Debit | Adjustments Credit | Books SW. C. G. U. Corp June 27, 1934 | Adjustments Debit | Adjustments Credit | Appraised Value June 27, 1934 | Adjustments Debit | Adjustments Credit | Cost Basis June 27, 1934 |
|---|---|---|---|---|---|---|---|---|---|---|
| | $ 3,200.00 | $ | $ | $ 3,200.00 | $ | $ 1,450.00 | $ 1,450.00 | $ | $ | $ 737.32 |
| | 109,000.00 | | | 109,000.00 | | 76.300.00 | 32,700.00 | | | 13,777.36 |
| | 45,500.00 | | | 45,500.00 | | 31,395.00 | 14,105.00 | | | 5.942.80 |
| | 735,000.00 | | | 735,000.00 | | 487,600.00 | 247,400.00 | | | 104,236.05 |
| | 185,000.00 | | | 185,000.00 | | | 185,000.00 | | | 77,945.31 |
| | $1,077,700.00 | | | $1,077,700.00 | | $ 596,745.00 | $ 480,955.00 | | $ 278,316.16 | $ 202,683.84 |
| | $ 344,400.00 | | | $ 344,400.00 | | $ 344,399.00 | $ 1.00 | | | $ .42 |
| | 85,450.00 | | | 85.450.00 | | 85,449.00 | 1.00 | | | .42 |
| | $ 429,850.00 | | | $ 429,850.00 | | $ 429.848.00 | $ 2.00 | | $ 1.16 | $ .84 |
| | $ 90,000.00 | | | $ 90,000.00 | | | $ 90,000.00 | | $ 52,080.66 | $ 37,919.34 |
| | $7,300,947.62 | | | $7.300,947.62 | $ 113,169.79 | $6,141,963.47 | $1,272,153.94 | | $ 736,162.41 | $ 535,991.53 |
| | $ 30,000.00 | | | $ 30,000.00 | | | $ 30,000.00 | | | $ 12,639.78 |
| | 338,141.00 | | | 338,141.00 | | $ 338,140.00 | 1.00 | | | .42 |
| | 576,341.25 | | | 576,341.25 | | 576,340.25 | 1.00 | | | .42 |
| | 199,457.50 | | | 199,457.50 | | 199.456.50 | 1.00 | | | .42 |
| | $1,143,939.75 | | | $1,143,939.75 | | $1,113,936.75 | $ 30,003.00 | | $ 17,361.96 | $ 12,641.04 |
| | $8,995,724.91 | | | $8,995,724.91 | $ 113,169.79 | $7,342,199.72 | $1,766,694.98 | | $1,014,694.98 | $ 752,000.00 |
| | $ 31,945.42 | $ 31,945.42 | $ 108,197.92 | $ 108,197.92 | $ | $ | $ 108,197.92 | $ | $ | $ 108,197.92 |
| | 425,608.14 | 425,608.14 | | | | | | | | |
| | 13,740.30 | 13,740.30 | | | | | | | | |
| | 126,000.00 | 126,000.00 | | | | | | | | |
| | 2,871,500.00 | 2,871,500.00 | | | | | | | | |
| | 2,684,376.50 | 2,684,376.50 | | | | | | | | |
| | 2,801,509.00 | 2,801,509.00 | 49,168.00 | 49,168.00 | | | 49,168.00 | | | 49,168.00 |
| | 41,045.55 | 41,045.55 | | | | | | | | |
| | | 157,265.02 | 8,995,724.91 | 8,838,358.99 | 7,542,199.72 | 113,169.79 | 1,609,329.06 | 1,014,694.98 | | 594,634.08 |
| | $8,995,724.91 | | | $8,995,724.91 | | | $1,766,694.98 | | | $ 752,000.00 |

28 United States Board of Tax Appeals
Filed June 23, 1938.

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321.

ANSWER

COMES NOW the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for his answer to the petition herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that he erred in his determination of the deficiencies as shown by the deficiency notice from which the taxpayer's appeal was taken. Specifically denies that he erred in the manner and form as alleged in subdivisions (I) to (VIII), inclusive, of paragraph 4 of the petition.

5. Denies the allegations contained in subdivision (a) to (j), inclusive, of subparagraph (I) of paragraph 5 of the petition. Denies the allegations contained in sub-

division (a), (b) and (c) of paragraph II of paragraph 5 of the petition. Denies the allegations
29 contained in subdivision (a) and (b) of subparagraph (III) of paragraph 5 of the petition. Denies the allegations contained in subdivisions (a) and (b) of subparagraph (IV) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (V) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VI) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VII) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VIII) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied and the taxes as shown in the deficiency notice be in all respects approved.

(Signed) J. P. WENCHEL,
GWK
Chief Counsel,
Bureau of Internal Revenue.

OF COUNSEL

JOHN H. PIGG,
Special Attorney,
Bureau of Internal Revenue.

JHP/lmv 6/22/38

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Filed March 13, 1939.
U. S. Board of Tax Appeals

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,
Petitioner,

-against-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321.

MOTION

The name of petitioner has been changed from Southwest Consolidated Gas Utilities Corporation to Southwest Consolidated Corporation, pursuant to action of the stockholders taken at a special meeting held January 6, 1939 and Certificate of Change of Name filed with the Secretary of State of the State of Delaware on January 12, 1939, certified copy of which was thereafter filed with the Recorder of Deeds for the County of New Castle, State of Delaware.

It is therefore moved that the style of this proceeding be changed accordingly and the petitioner hereafter be referred to in this proceeding as Southwest Consolidated Corporation.

(s) A. C. NEWLIN
Counsel for Petitioner

Dated: March 13, 1939.

NO OBJECTION
(s) J. P. Wenchel
Chief Counsel,
Bureau of Internal Revenue.

31 UNITED STATES BOARD OF TAX APPEALS

| | |
|---|---|
| SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent. | Docket No. 93321. |

ORDER CHANGING TITLE OF PROCEEDING.

On motion of the petitioner to change the title of the proceeding filed in the above-entitled case on March 13, 1939, to which counsel for the respondent interposes no objection, it is—

ORDERED that the title of this proceeding be and the same is hereby changed to read "Southwest Consolidated Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent."

(s) J. RUSSELL LEECH
Member.

JRL:aa.

Dated: March 15, 1939.

(SEAL)

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UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED CORPORATION, PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 93321.√

Fred Simon, esq. and A. Chauncey Newlin, Esq., for the petitioner.

Joe D. Hughes, Esq., for the respondent.

MEMORANDUM OPINION.

SMITH: This proceeding involves income and excess-profits taxes for the year 1934 and 1935 as follows:

| | Income Tax | Excess-Profits Tax |
|---|---|---|
| 1934 | $14,991.68 | $3,545.27 |
| 1935 | 24,623.07 | 4,522.39 |

The question in issue in both years is the cost basis to the petitioner of certain assets formerly owned by a predecessor corporation which it acquired in exchange for its own stock and securities.

Petitioner is a Delaware corporation organized June 27, 1934, and is the successor of Southwest Gas Utilities Corporation whose assets it acquired under foreclosure sale soon after its organization.

Southwest Gas Utilities Corporation, hereinafter referred to as the Utilities Company, was a public utilities corporation organized under the laws of the State of Delaware on April 10, 1928.

33 On May 1, 1932, the Utilities Company defaulted in the payment of its interest on certain of its outstanding bonds, being a series of 6½% First Lien and Secured Sinking Fund Gold Bonds in the face amount of $2,871,500, which were issued under authorization of an indenture dated May 1, 1928, between the Utilities Company and Chatham Phenix National Bank & Trust Co. as trustee. Under this indenture the Utilities Company pledged certain of its assets including shares of stock and bonds of its subsidiary companies with the trustee as security for the bond issue. On May 19, 1932, the pledged securities were transferred to the Manufacturers Trust Co., successor trustee to the Chatham Phenix National Bank & Trust Co.

On May 2, 1932, a bondholders' committee was organized to protect the interests of the bondholders. Members of the committee later became directors of the Utilities Company and, after October 7, 1932, were in control of it. About 85 percent of the outstanding bonds were deposited with the committee.

On April 10, 1933, a bill in equity was filed in the Court of Chancery of the State of Delaware, New Castle County, by one of the bondholders alleging insolvency of the Utilities Company and praying for the appointment of a receiver. The Utilities Company admitted insolvency, in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Charles F. Richards of Wilmington, Delaware, and Charles G. Laskey of Shreveport, Louisiana, president of the Utilities Company, were appointed receivers.

34 On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization" for the Utilities Company. It is not necessary for the purpose of our decision to give a full disclosure of the details of the reorganization plan. It provided in brief that a new company should be organized (the petitioner herein) which would acquire by direct purchase or under foreclosure proceedings the collateral assets held by the Manufacturers Trust Co. and also any "free assets" of the Utilities Company which the committee might consider of value to the new company. The capital structure of the new company was as follows:

| Description | Amount Authorized | Amount Issued |
|---|---|---|
| Common stock, $1 par value | 200,000 shares | 57,718 shares |
| Class A Option Warrants | 2,880 warrants | 2,880 warrants |
| Class B Option Warrants | 50,000 warrants | 34,682-3/10 warrants |

The common stock had a par value of $1 per share or "such different par value" as the committee might think best. The Class A option warrants carried the right to buy one share of common stock at $6 a share during 1934 and at an increase of $1 per share for each year thereafter up to and including 1938. Similarly, the Class B option warrants carried the right to buy one share of common stock at $10 a share during 1934 and at an increased price of $5 per share for each succeeding year up to and including 1938.

The plan of reorganization provided for the diposition of securities of the new company as follows:

> The holders of the outstanding First Lien and Secured sinking fund Gold Bonds 6½% Series, due 1943, of the Company, who participate in the plan will receive new securities on the basis of twenty shares of common stock in the New Company for each $1000 principal amount held.

35 The holders of Five Year 6% Convertible Gold Notes due October 1, 1934, of the Company will receive two shares of common stock of the New Company and twenty Class A warrants of the New Company for each $1000 principal amount held.

Holders of unsecured claims against the Company, which may be proved and allowed in the receivership proceedings, will be afforded equal treatment with the holders of the Five-Year 6% Convertible Gold Notes of the Company and will receive two shares of Common Stock of the New Company and twenty (20) Class A Warrants of the New Company for each $1,000 principal amount of claim allowed.

The holders of $6.50 Preferred Stock of the Company will receive one Class B Warrant of the New Company for each share held.

The holders of common stock of the Company will receive one Class B Warrant* of the New Company for each fifty shares held.

[* Not material]

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against the Utilities Company and on May 11, 1934, the Chancellor issued a decree approving the reorganization plan.

Pursuant to such plan of reorganization and by order of the Chancery Court the assets pledged as security for the bonds of Utilities Company were sold by the trustee at foreclosure sale on June 25, 1934, and bid in by the bondholders' committee at a price of $660,000. The unpledged assets of the Utilities Company were purchased by the bondholders' committee at public auction on June 18, 1934, for $92,000. The sale of these assets was confirmed by the Chancery Court.

Pursuant to the plan of reorganization, common stock and "A" and "B" warrants of the petitioner were
36 issued and exchanged for bonds, notes, claims and stock of Utilities Company, as follows:

| UTILITIES COMPANY | | | SOUTHWEST CONSOLIDATED | | |
|---|---|---|---|---|---|
| | | | Securities Issued in Exchange Pursuant to Plan | | |
| Security | Total Amount | Amount Participating in Plan | Common Stock | A Warrants | B Warrants |
| Bonds | $2,871,500.00 | $2,450,500.00 | 49,010 | | |
| Notes | $ 126,000.00 | $ 107,000.00 | 214 | 2,140 | |
| Other Unsecured Claims | $ 31,945.42 | $ 31,945.42 | 62 | 620 | |
| Preferred Stock | 32,244 sh. | 17,297 | | | 17,297 |
| Common Stock | 171,915 | 57,470 | | | 1,148 7/50 |
| | | | 49,286 | 2,760 | 18,445 7/50 |

Non-participating security holders of Utilities Company ($421,000 of bonds and $19,000 of notes) received $106,-684.06 in cash. The cash necessary to make this payment and to meet the expenses connected with the sale of the pledged and unpledged assets of Utilities Company was obtained by means of a loan from Manufacturers Trust Co., which loan was assumed by the petitioner and was later repaid by it.

Holders of $871,500 principal amount of bonds and $65,000 principal amount of notes of Utilities Company participating in the plan of reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes these security holders received 17,560 shares of common stock of the petitioner and 1300 Class A warrants. With respect to their holdings of common and preferred stock of Utilities Company these individuals received 3,132 Class B warrants.

37 Giving effect to this situation, the following table shows total distribution of common stock, and warrants to purchase common stock, of the petitioner to former stockholders of Utilities Company and to non-stockholders:

| Class of Security of Southwest Consolidated | Total Issued by Southwest Consolidated | Issued to Stockholders of Utilities Co. | Issued to Nonstockholders of Utilities Co. |
|---|---|---|---|
| Common Stock | 49,286 | 17,560 | 31,726 |
| Class "A" Warrants | 2,760 | 1,300 | 1,460 |
| Class "B" Warrants | 18,445 7/50 | 18,445 7/50 | |
| Total | 70,491 7/50 | 37,305 7/50 | 33,186 |

Of the 2,760 Class "A" warrants issued, 1,760 were exercised, and of the 18,455-7/50 Class "B" warrants issued, 4,623 were exercised, before they expired in 1938.

The cost to Utilities Company for the assets transferred to the petitioner as of June 27, 1934, was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98. These aggregate figures were divided among the various assets.

Upon petitioner's organization and during 1934 all of the Utilities Company's assets, or the bondholders' rights to such assets, were assigned to it.

The Utilities Company filed a final income and excess-profits tax return for the calendar year 1934 in which it reported a loss of $257,647.93 for the period January 1, 1934, to June 27, 1934.

Petitioner filed an income and excess-profits tax return for the period June 27, 1934, to December 31, 1934, in which it reported a net loss of $48,307.10. In his de-

38 ficiency notice the respondent determined a net income for that period of $109,030.43. The principal adjustments made by the respondent were the disallowance of bad debts in the amount of $75,086.74 and additions to income of $60,700.69 representing "gain realized from interest collected" and $19,530.10 representing "Gain realized from collection of advances." The debts and accounts referred to were among the assets of the Utilities Company which were assigned to the petitioner under the reorganization plan described above. Bad debts were charged off by the petitioner in the total amount of $75,090. Respondent does not question the worthlessness of the debts but contends that the aggregate cost to the petitioner, on the theory that they were not acquired in a statutory reorganization, was only $1.26. Accordingly he has disallowed the balance of the amount which petitioner charged off.

The additions to petitioner's income of interest and advance collected were made on the same theory, that is, that the cost basis of the accounts to the petitioner was not their face value, or their cost to the Utilities Company, but the price which the petitioner paid for them at the foreclosure sale, amounting to $44,195.77 as to the interest accounts, and $14,219.65 as to the advances to subsidiary companies.

Petitioner filed a return for 1935 in which it reported a net loss of $3,392,737.55 while the respondent has determined that petitioner had a net income in that year of $179,076.90. The principal adjustments made by the respondent for that year are as follows:

| | |
|---|---|
| (a) Worthless stocks disallowed | $3,477,577.00 |
| (b) Capital net gain restored | 67,064.13 |
| (c) Capital net loss disallowed | 2,000.00 |
| (d) Gain from collections from affiliates | 25,174.80 |
| Total | $3,571,815.93 |

39 The above adjustments result in the main from the respondent's determination that petitioner did not acquire the assets of Utilities Company in a reorganization and that the cost basis of the assets to the petitioner is not the same as it was to the Utilities Company but is the price at which the assets were bid in by the bondholders' committee at the foreclosure sale.

The parties are in agreement that the cost basis to the petitioner of the assets of Utilities Company is the only question in issue in this proceeding. If such cost basis to the petitioner is found to be the same as it was to the Utilities Company petitioner will have no tax liability for either of the taxable years involved.

The pertinent provisions of the statute are found in sections 112 and 113 of the Revenue Act of 1934, which read in part as follows:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in Kind.—

* * * * *

(4) Same—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to Corporation Controlled by Transferror.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * * *

(g) Definition of Reorganization.—As used in this section and section 113—

(1) The term "reorganization" means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, * * *

* * * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * * * *

(7) Transfers to Corporation Where Control of Property Remains in Same Persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as to the consideration in whole or in part for the transfer.

(8) Property Acquired By Issuance of Stock or as Paid-In Surplus.—If the property was acquired after December 31, 1920, by a corporation—

41 (A) By the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

Then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

By section 112 (g) (1) "The term 'reorganization' means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: * * * of substantially all the properties of another corporation".

In the proceeding at bar the petitioner acquired all of the assets of the Utilities Company in exchange for its shares of stock and warrants. The respondent submits:

* * * While petitioner acquired the remaining assets of the old company, it acquired those assets from the bondholders' committee rather than from the old company and the acquisition by one corporation of the property of another corporation from third parties does not constitute a non-taxable reorganization. * * *

The Board is of the opinion that this contention made by the respondent does not apply to the proceeding at bar.

In Commissioner v. Kitselman (CCA, 7th Cir), 89 Fed. (2d) 458, Art. Trn. 302 U. S. 709, the court held, reversing the Board, that a statutory reorganization occurred where, under facts almost identical with those in the instant case,

the assets of an insolvent corporation which were
42 pledged as security for the corporation's bonds were purchased at foreclosure sale by the bondholders' committee and were assigned to the new corporation in exchange for its stock and securities. The court, in its opinion, said:

> Bondholders are ordinarily viewed merely as creditors, but when the assets of the corporation are less than its obligations, the bondholders are in actuality and for all practical purposes pretty much the corporation. All that remains for the stockholders is the corporate charter—the corpse of the defunct corporation. When the new corporation was formed by the bondholders' representatives, it received all the corporate assets in exchange for the new company's stocks and bonds. The old stockholders as such received nothing.
>
> There may not have been a reorganization in the sense that the capital structure was changed (except as to the bonds), but the essence of the corporate life—all its assets, were transferred by its bondholders to a new corporation in exchange for that corporation's stocks and bonds. It is not indispensable to a reorganization that there be a dissolution of the old corporation.
>
> The novelty of this situation arises from the lack of participation by stockholders of the transferor corporation. If they participated, there would be little doubt as to the existence of a reorganization.
>
> It is clear that the bondholders were the moving spirit and were treated as the owners in fact, and it follows that they must be viewed as a class of "stockholders" somewhat akin to preferred stockholders with cumulative dividend rights. Their position was stepped up by reason of what had occurred and the finding that there was no equity over the lien of the mortgage. Where the assets of the corporation fall far below the amount required to pay the bondholders in full, the bondholders in bankruptcy reorganization supersede the stockholders. They acquire the stockholders' rights to manage the corporate affairs. * * *

43 Also in commissioner v. Newberry Lumber & Chemical Co., 94 Fed. (2d) 447, the Circuit Court of Appeals for the Sixth Circuit reached the same conclusion (reversing 33 B.T.A. 150) on substantially the same facts. The court there said:

> In the case at bar neither the petitioner nor its stockholders received any profit from the reorganization. The predecessor corporation transferred all of its assets to the petitioner, and immediately after, the transferor, through its bondholders, was in control of the assets transferred. It makes no difference that the transaction was effected by the bondholders' committee, for that committee acted for and represented the bondholders in the old corporation, who became bondholders and stockholders in the reorganized corporation. Nor is it important that the committee represented no stockholders in the original corporation, since it did represent the bonds, which are securities as indicated in the Minnesota tea Company and Watt Cases, supra. In our opinion there was a reorganization within the meaning of the statute. Where there is a reorganization there is no taxable gain in the transaction. In such case, too, the statute provides that the capital base for the reorganized corporation is the cost of the assets to the old corporation. Section 113 (a) (7) and section 114 (a) and (b) (1), of the Revenue Act of 1928, 26 U.S.C.A. § § 113, 114 notes. * * *.

In Frederick L. Leckie, 37 B.T.A. 252, the Board followed Commissioner Kitselman, supra, holding, upon facts not materially different from those in the instant case, that a reorganization took place where assets of a corporation in default of its first mortgage bonds were bid in at foreclosure sale by a bondholders' committee and transferred to a new corporation in exchange for its stock which was ultimately distributed to the participating bondholders.

See also Howard Hotel Corporation, 39 B.T.A. 1147.

44 On authority of the cases cited we hold that under the facts set out above there was a statutory reorganization and that the cost basis to the peitioner of the assets acquired by it pursuant to such plan of reorganization is the same as the cost basis of the assets in the hands of the Utilities Company.

Decision of no deficiency will be entered.

Copies served on both Parties

ENTERED AUG 25 1939

(SEAL)

45 UNITED STATES BOARD OF TAX APPEALS

WASHINGTON

SOUTHWEST CONSOLIDATED CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321

DECISION

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion, entered August 25, 1939, it is

ORDERED AND DECIDED: That there are no deficiencies in income or excess-profits taxes for the years 1934 and 1935.

(Signed) CHARLES P. SMITH
Member.

Entered Aug 25 1939

(Seal)

46 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Nov 25 1939

| | |
|---|---|
| GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review. | B. T. A. Docket No. 93321 |

# PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

NOW COMES the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

## I.

## JURISDICTION

The petitioner on review is the duly appointed, qualified and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States.

The respondent on review, Southwest Consolidated Corporation (formerly known as Southwest Consolidated Gas Utilities Corporation) hereinafter referred to as the taxpayer, is a corporation organized under the laws of the State of Delaware, with its principal office at Rooms 901-913 Slattery Building, Shreveport, Louisiana. The taxpayer filed its Federal income and excess-profits tax returns for the taxable years of 1934 and 1935 with the Collector of Internal Revenue for the district of Louisiana and within the judicial district of the United States Circuit Court of Appeals for the Fifth Circuit.

47

## II.

## PRIOR PROCEEDINGS

On February 17, 1938, the Commissioner determined deficiencies in income taxes against the taxpayer for the taxable years ended December 31, 1934 and 1935 in the respective amounts of $14,991.68 and $24,623.07, and deficiencies in excess-profits tax for those years in the respective amounts of $3,545.27 and $4,522.39, and sent by registered mail a notice of said deficiencies in accordance with section 272 of the Revenue Act of 1934. Thereafter and on May 5, 1938, the taxpayer filed a petition for a redetermination of said deficiencies by the United States Board of Tax Appeals.

The case was tried before the Board of Tax Appeals on January 23, 1939 at Shreveport, Louisiana.

On August 25, 1939, the Board entered its memorandum opinion, and on August 25, 1939 entered its decision wherein it was ordered and decided that there are no deficiencies in income or excess-profit taxes for the years 1934 and 1935.

48

## III

## NATURE OF CONTROVERSY

The question presented was what is the proper cost basis to the taxpayer of certain assets formerly owned

by a predecessor corporation which it acquired in exchange for its own stock and securities.

The taxpayer herein is the successor of the Southwest Gas Utilities Corporation, hereinafter referred to as Utilities Company. On May 1, 1932, the Utilities Company was in default in the payment of interest on its outstanding First Lien and Secured Sinking Fund Gold Bonds with a face value of $2,871,500. A bondholders' committee was organized to protect the interest of the bondholders and the members of the committee became directors of the Utilities Company. A bill in equity was filed by the committee alleging insolvency of the Utilities Company and praying for the appointment of a receiver. The Utilities Company admitted it was insolvent.

Pursuant to a "Plan of Reorganization" adopted by the committee a new corporation (the taxpayer herein) was organized to acquire by purchase under foreclosure proceedings, the assets of the Utilities Company. The new company was authorized to issue 200,000 shares of common stock with a par value of $1 a share and to issue class A and B option warrants in the respective amounts of 2,880 and 50,000. These warrants permitted the holders thereof to purchase common stock of the new company at a specified price within a given time limit.

Pursuant to the plan of reorganization the assets of the Utilities Company were purchased by the bondholders' committee and in turn assigned to the
49 new corporation. The holders of bonds, notes and preferred stock of the Utilities Company exchanged their holdings for stock and Class A and B warrants of the new company. Of the total outstanding bonds of the Utilities Company amounting to $2,871,000, holders of $2,450,500 of said bonds participated in the plan of reorganization. Likewise of the notes outstanding against said Utilities Company of $126,000, the holders of $107,000 worth of the notes participated in the reorganization.

The Commissioner determined that taxpayer did not acquire the assets of Utilities Company in a reorganization and that the cost basis of the assets to the taxpayer was not the same as it was to the Utilities Company, but was the price at which the assets were bid in by the bondholders' committee at the foreclosure sale. The Board held that the transaction in question constituted a statutory reorganization and and that the cost basis to the taxpayer of the assets acquired by it pursuant to such plan of reorganization was the same as the cost basis of the assets in the hands of the Utilities Company.

## IV.

## ASSIGNMENTS OF ERROR

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals:

50 1. The Board erred in holding and deciding that there are no deficiencies in income or excess-profits taxes for the years 1934 and 1935.

2. The Board erred in failing to hold and decide that there are deficiencies in income taxes for the taxable years 1934 and 1935 in the respective amounts of $14,991.68 and $24,623.07, and deficiencies in excess-profits taxes for those years in the respective amounts of $3,545.27 and $4,522.39.

3. The Board erred in holding and deciding that on authority of the cases cited by it, there was a statutory reorganization and that the cost basis to the taxpayer of the assets acquired by it pursuant to such plan of reor-

ganization is the same as the cost basis of the assets in the hands of the Utilities Company.

4. The Board erred in failing to hold and decide that there was no statutory reorganization and that the cost basis to the taxpayer of the assets acaquired by it from the bondholders' committee was the price at which the assets were bid in by the bondholders' committee at the foreclosure sale.

5. The Board erred in that its decision is not supported by the evidence and is contrary to law.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fifth Circuit, that a transcript of the record be pre-
51 pared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

(Signed) SAMUEL O. CLARK, Jr.,

Assistant Attorney General

(Signed) J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

OF COUNSEL:

JOHN M. MORAWSKI,

Special Attorney,

Bureau of Internal Revenue.

52 UNITED STATES OF AMERICA )
DISTRICT OF COLUMBIA )

JOHN M. MORAWSKI, being duly sworn, says that he is a Special Attorney in the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Signed) JOHN M. MORAWSKI,

Special Attorney,

Bureau of Internal Revenue.

Sworn and subscribed to before me
this 25 day of November, 1939.

(Signed) GEORGE W KILIS

Notary Public.

My commission expires Nov. 15, 1942.

53 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Dec 4 1939

| | |
|---|---|
| GUY T. HELVERING, Commissioner of Internal Revenue,<br><br>Petitioner on Review,<br><br>v.<br><br>SOUTHWEST CONSOLIDATED CORPORATION,<br><br>Respondent on Review. | B. T. A.<br><br>Docket No. 93321 |

NOTICE OF FILING PETITION FOR REVIEW

To: Southwest Consolidated Corporation,
901 Slattery Building,
Shreveport, Louisiana.

You are hereby notified that the Commissioner of Internal Revenue did on the 25th day of November, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 27th day of November, 1939.

(Signed) J. P. WENCHEL,
RLW
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 28 day of November, 1939.

SOUTHWEST CONSOLIDATED CORPORATION

By (Signed) GEORGE BELCHIC

Vice President

Respondent on Review.

54 Copy

Shreveport, La.,
Nov. 25, 1939.

Southwest Consolidated Corporation,

901 Slattery Bldg.,

Shreveport, La.,

Sirs:

I am in receipt of instructions from J. P. Wenchel, Chief Counsel, Internal Revenue, Washington, D. C., to serve upon you the following, in the U. S. Circuit Court of Appeals for the 5th Circuit, Guy T. Helvering, Commissioner of Internal Revenue, petitioner, on review versus Southwest Consolidated Corporation, respondent on review BTA No. 93321, notice of filing petition for review to Southwest Consolidated Corporation, 991 Slattery Bldg., Shreveport, La.

You are hereby notified that the Commissioner of Internal Revenue did, on the 25th day of November, 1939,

file with the clerk of the U S Board of Tax Appeals at Washington, D. C., a petition for review by the U S Circuit Court of Appeals for the 5th Circuit of the decision of the Board heretofore rendered in the above entitled case.

Respectfully,

(Signed) A. R. LACEY,

Internal Revenue Agent.

This is to certify the foregoing notice was served upon Mr. George Belchic, Vice-President, Southwest Consolidated Corporation, in person at his residence, 6500 Gilbert Drive, Shreveport, La., 5.15 PM, November 25th, 1939.

(Signed) A. R. LACEY,

Internal Revenue Agent.

55 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Dec 4 1939

| | |
|---|---|
| GUY T. HELVERING, Commis-<br>Petitioner on Review,<br>v.<br>SOUTHWEST CONSOLIDATED CORPORATION,<br>Respondent on Review. | B. T. A.<br>Docket No. 93321 |

## NOTICE OF FILING PETITION FOR REVIEW

To: Fred Simon,

Attorney for Southwest Consolidated Corporation,

Ricou-Brewster Building,

Shreveport, Louisiana.

You are hereby notified that the Commissioner of Internal Revenue did on the 25th day of November, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 27th day of November, 1939.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 28 day of November, 1939.

(Signed) FRED SIMON

Counsel for Respondent on Review.

56

COPY

Shreveport, La., Nov. 25, 1939

Fred Simon, Attorney,

S. W. Consolidated Corp.,

Ricou-Brewster Bldg.,

Shreveport, La.

Sir:

I am in receipt of instructions from Mr J P Wenchel, Chief Counsel Internal Revenue, Washington, D. C., to serve upon you as attorney for the Southwest Consolidated Corp., Shreveport, La., notice of filing petition for review, in the U. S. Circuit Court of Appeals for the 5th Circuit, Guy T Helvering, Commissioner of Internal Revenue, petitioner on review versus Southwest Consolidated Corporation, respondent on review BTA No. 93321.

You are hereby notified that the Commissioner of Internal Revenue did, on the 25th day of November, 1939 file with the clerk of the U. S. Board of Tax Appeals at Washington, D. C., a petition for review by the U. S. Circuit Court of Appeals for the 5th Circuit of the decision of the Board heretofore rendered in the above entitled case.

Respectfully,

(signed) A. R. LACEY

Internal Revenue Agent.

This is to certify the foregoing notice was served upon Mr. Fred Simon, Attorney, for Southwest Consolidated Corporation, in person at his residence 225 Merrick Street, Shreveport, La., 6.15 PM, November 25th, 1939.

(signed) A. R. LACEY

Internal Revenue Agent.

58

57

Received

U. S. Board of Tax Appeals

Nov 25 1939

Form 7951-A

Postal Telegram

TREASURY DEPARTMENT

Bureau of Internal Revenue

Telegraph Office

5PO W 36 5 EXTRA ANSWER REQUESTED

SY SHREVEPORT LA 1002A NOV 25 1939

CLERK

U. S. BOARD TAX APPEALS

WASHINGTON DC

WILL APPRECIATE YOU ADVISING BY WIRE COLLECT IF APPEAL HAS BEEN FILED BY COMMISSIONER IN SOUTHWEST CONSOLIDATED CORPORATION CASE DOCKET NO. 93,321 STOP UNDERSTAND TIME FOR APPEAL WILL EXPIRE TODAY

SOUTHWEST CONSOLIDATED CORPN

901 SLATTERY BUILDING

SHREVEPORT LOUISIANA

58 BUREAU OF INTERNAL REVENUE

TELEGRAPH OFFICE

1939 NOV 25 PM 1 01

From U. S. BOARD OF TAX APPEALS

COLLECT

NOV. 25, 1939

SOUTHWEST CONSOLIDATED
CORPORATION,

901 SLATTERY BUILDING,

SHREVEPORT, LOUISIANA.

RETEL COMMISSIONER FILED APPEAL SOUTHWEST CONSOLIDATED CORPORATION TODAY

B. D. GAMBLE,

CLERK

93321 jd

BDG

59 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Apr 24 1940

| | |
|---|---|
| GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review. | B. T. A. Docket No. 93321 |

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Fifth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.

2. Pleadings:

   (a) Petition

   (b) Answer to petition.

3. Order changing title of proceeding together with motion of taxpayer to change title.

4. Memorandum opinion entered August 25, 1939.

5. Decision entered August 25, 1939.

6. Petition for review.

7. Notices of filing petition for review.

8. Telegram dated November 25, 1939, addressed to Board from taxpayer, together with telegram of same date from Board to taxpayer.

60 9. This praecipe.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted and the said praecipe agreed to this 12 day of April, 1940.

(Signed) A. C. NEWLIN

Attorney for Respondent on Review.

UNITED STATES BOARD OF TAX APPEALS

WASHINGTON

| | |
|---|---|
| COMMISSIONER OF INTERNAL REVENUE, Petitioner, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent. | Docket No. 93321 |

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 60, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 30th day of April 1940.

B. D. GAMBLE

(Seal) Clerk,

United States Board of Tax Appeals.

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

*Argument and submission*

Extract from the Minutes of December 4th, 1940

No. 9524

COMMISSIONER OF INTERNAL REVENUE

*v.*

SOUTHWEST CONSOLIDATED CORPORATION

On this day this cause was called, and, after argument by Samuel O. Clark, Jr., Esq., Assistant Attorney General, for petitioner, and A. Chauncey Newlin, Esq., for respondent, was submitted to the Court.

*Opinion of the Court filed April 19, 1941*

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 9524

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

SOUTHWEST CONSOLIDATED CORPORATION, RESPONDENT

Petition for review of decision of the United States Board of Tax Appeals (District of Louisiana)

(April 19, 1941)

Before FOSTER, HUTCHESON, and HOLMES, Circuit Judges

FOSTER, Circuit Judge: Respondent, Southwest Consolidated Corporation, acquired all the assets of Southwest Gas Utilities Corporation, in June 1934, through the medium of a bondholders' committee in a reorganization to which both corporations were parties. In making returns for income and excess-profits taxes for 1934 and 1935 respondent claimed losses for certain worthless assets charged off and took the cost of the assets to the old cor-

poration as a basis for determining loss or gain. The Commissioner disallowed the deductions; held there had been no tax-exempt reorganization; that the transfer was in fact a purchase from the bondholders' committee, a third person; that respondent acquired the assets of the old company at the price they were bid in by the bondholders' committee and was not entitled to take their cost to the old company as a basis for determining gain or loss; and determined deficiencies. The Board of Tax Appeals reversed the Commissioner, holding there had been a tax-exempt reorganization under the provisions of Sections 112 and 113 of the Revenue Act of 1934;[1] relying upon Commissioner vs. Kitselman, 89 F. (2d) 458, certiorari denied, 302 U. S. 708; Commissioner vs. Newberry Lumber & Chemical Co., 94 F. (2d) 447, and various of its own decisions, in which it was held that the bond-

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[1] SEC. 112. RECOGNITION of GAIN or LOSS.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in Kind.—

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(4) Same-Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to Corporation Controlled by Transferor.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

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(g) Definition of Reorganization.—As used in this section and section 113—

(1) The term "reorganization" means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, * * *

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SEC. 113. ADJUSTED BASIS for DETERMINING GAIN or LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

(7) Transfers to Corporation Where Control of Property Remains in Same Persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as to the consideration in whole or in part for the transfer.

(8) Property Acquired by Issuance of Stock or as Paid-In Surplus.—If the property was acquired after December 31, 1920, by a corporation—

(A) By the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities, or

(B) As paid-in surplus or as a contribution to capital,

Then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

By Section 112 (g) (1) "The term 'reorganization' means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: * * * of substantially all the properties of another corporation."

holders of an insolvent corporation, after default have a pecuniary interest in the assets.

As the opinion of the Board is not published it is necessary to review the material facts. On May 1, 1932, Southwest Gas Utilities Corporation defaulted in the payment of interest on certain of its bonds, maturing in 1943. It had outstanding 171,915 shares of common stock, 32,244 shares of preferred stock, $2,871,500 of said first lien bonds, secured by pledge of certain assets, including stocks and bonds of subsidiary companies, $126,000 convertible gold notes, unsecured, and $31,945 of other unsecured claims.

A bondholders' committee was organized and about 85 percent of the outstanding bonds were deposited with it. Members of this committee became directors of the company and after October 7, 1932, constituted a majority of the board. On April 10, 1933, a bill in equity was filed in the Court of Chancery, in Newcastle, Delaware, on which receivers were appointed in March 1934. The bondholders' committee was permitted to intervene and a plan of reorganization was proposed and adopted. Under it a new company, respondent, was incorporated, with the right to acquire by direct purchase or foreclosure the assets of the old company. The new company had a financial setup of 200,000 shares of common stock, par value $1.00 or such par value as might be given them, 2880 Class A option warrants and 50,000 Class B option warrants. The option warrants carried the right to buy common stock at respectively $6.00 and $10.00 per share, increasing yearly up to and including 1938. They were doubtless intended to bring in new money and had some present value, which would increase if the company prospered. Based on the fair market value of the assets acquired, the stock of the new company had a book value of $8.85 a share for the whole authorized stock and about $35.00 per share for the amount issued. But, as they did not of themselves transfer any interest in the new company, they may be disregarded in deciding the case.

Pursuant to the plan of reorganization by order of the chancery court, the assets pledged as security for the bonds were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the bondholders' committee at the price of $660,000. The unpledged assets were sold at public auction on December 16, 1934, for $92,000 and they were also bid in by the bondholders' committee. The cost to the old corporation of these assets was $8,995,724 and their fair market value was $1,766,694. These sales were confirmed by the chancery court and all the assets were transferred to the new corporation in exchange for its stock and warrants. In order to effect the exchange of assets respondent issued 49,286 shares of common stock, 2,760 Class A and 18,445 Class B

warrants. Those participating in the plan held $2,450,500 of bonds, $126,000 of notes, 17,297 shares preferred stock (over 53%) and 57,470 shares common stock (over 33%) of the old company. They received 49,224 shares common stock (over 99%) of the new company, 2,140 Class A and 18,445 Class B warrants. Non-participating security holders holding $421,000 of bonds and $19,000 of notes received $106,684 in cash.

From the above recited facts it is apparent the case is similar to those considered in the Kitselman and Newberry cases, *supra*, but is somewhat stronger in favor of the taxpayer because the bondholders agreeing to the plan of reorganization also held substantial stock in the old company.

However, the Commissioner relies upon the case of LeTulle vs. Scofield, 308 U. S. 415 as overruling those cases and demanding a contrary decision in this case. We cannot agree with this contention. In the LeTulle case the transferor received only securities of the transferee, the reverse of the situation in this case, and it was held that in the absence of stock control the transferor became merely a debtor of the transferee, retained no stake in the enterprise, and did not have a continuing pecuniary interest in the assets transferred. The case may be easily distinguished and we do not consider it controlling. The Commissioner also cites Comissioner vs. Bondholders' Committee, Malborough Inv. Co. and Commissioner vs. Malborough House, Inc., . . . F. (2d) . . ., decided after this case was submitted. Those cases may be distinguished from the case at bar. In them apparently there was no initial plan of reorganization but there were a series of happenings from which the Board of Tax Appeals inferred the existence of a plan. We do not find those decisions persuasive when applied to the facts before us.

There is no doubt in this case there was a reorganization in good faith pursuant to a plan adopted by a large majority of all the parties in interest, bondholders, noteholders, stockholders, and even unsecured creditors. It was proposed and worked out by the bondholders' committee and was approved by the Court having custody of the property. It cannot be said the bondholders' committee was a third person. When the plan of reorganization was proposed and adopted the committee was in complete control of the old company. It must be presumed they constituted a majority of the Board of Directors with the consent of the stockholders. The bondholders had a pecuniary interest in the assets of the old company to the exclusion of all others. Immediately after the transfer they were in complete control of the transferee and their pecuniary interest in the assets continued. In effect, the committee was the agent of the old company in the transfer of the assets. When they bid them in at public auction they held

them as trustee for the new company. In principle and in substantial results the transfer was the same as if it were direct from the old company.

The judgment of the board is affirmed.

*Judgment*

Extract from the Minutes of April 19th, 1941

No. 9524

COMMISSIONER OF INTERNAL REVENUE

*v.*

SOUTHWEST CONSOLIDATED CORPORATION

This cause came on to be heard on the petition of Commissioner of Internal Revenue for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that the judgment of the said United States Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

*Clerk's Certificate*

UNITED STATES OF AMERICA,
*United States Circuit Court of Appeals, Fifth Circuit.*

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 63 to 70 next preceding this certificate contain full, true, and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 9524, wherein Commissioner of Internal Revenue is petitioner, and Southwest Consolidated Corporation is respondent, as full, true, and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 62 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 7th day of July, A. D. 1941.

OAKLEY F. DODD,
*Clerk of the United States Circuit Court of Appeals, Fifth Circuit.*

U. S. GOVERNMENT PRINTING OFFICE: 1941

## Supreme Court of the United States

*Order allowing certiorari*

**Filed October 13, 1941**

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1941